Internal Revenue Service

memorandum

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date: APR 13 1988

to: District Counsel, Dallas SW:DAL
Attn: John Repsis

from: Director, Tax Litigation Division CC:TL

subject: Technical Advice - [redacted]

By Memorandum, dated March 29, 1988, it was requested that we provide technical assistance with respect to the above case. The issue involved has been discussed at length with John Repsis of your office and the Appeals Officer, Jim Stephens, on several occasions. The following more fully sets forth our views on that issue.

ISSUE

Whether petitioner was entitled to deduct in the taxable year ending [redacted], a $[redacted] contribution made to a Voluntary Employees' Beneficiary Association ("VEBA") Trust at the end of that taxable year for benefits to be provided in the next year.

CONCLUSION

Because of the substantial hazards involved in litigating the foregoing issue in the circumstances presented here, we recommend that the case be conceded in the event that a settlement cannot be reached.

DISCUSSION

On [redacted], the petitioner established a health and welfare benefits plan. The plan employs the same fiscal year as that of the corporation ([redacted]). The plan provides for life, health, dental and weekly disability benefits. These benefits are provided to participants through insurance coverage paid for by monies out of the Trust. On [redacted], the Corporation contributed $[redacted] to the Trust for the purpose of funding the plan's estimated insurance premiums for the plan year ending [redacted]. The entire amount of this contribution was claimed as a deduction in the [redacted] taxable year, resulting in a net operating loss carryback. The petitioner is an accrual method taxpayer.

We believe that complete concession of the VEBA deduction issue is warranted in the circumstances of this case. First, the litigations hazards are considerable despite the recent decision of the Supreme Court in United States v. General Dynamics Corp., 55 U.S.L.W. 4526 (April 22, 1987) respecting the "all events" test under I.R.C. § 461(a). In our view, General Dynamics is not controlling here because unlike the medical plan involved in that case, the plan here is funded through a separate trust. And, where a welfare benefit plan is so funded, the Service has essentially taken the position that the "all events" test (which is now codefied in I.R.C. § 461(h)) is satisfied when the contribution is made to the trust. */ See Treas. Reg. § 1.162-10, § 1.419-1T (Q&A-10(e)) & § 1.461(h)-4T (Q&A-1). Moreover, even though the contribution here created a reserve which had a useful life beyond the tax year involved, it will be difficult to convince a court that its useful life was "substantially" beyond that year as the regulations require. See Treas. Reg. § 1.419-1T (Q&A-10(b) & § 1.461-1(a)(2). This derives primarily from the fact that most of the contribution was expended under the plan in the next year. See, e.g., Zaninovich v. Commissioner, 616 F.2d 429, 432 (9th cir. 1980) (one-year rule for capitalization).

In addition, the economic performance rules of IRC § 461(h), which are apparently applicable to the [redacted] taxable year, are also of no help. Thus, the applicable regulations specify that for welfare benefits provided through an irrevocable trust, economic performance occurs when the contribution is made to the trust. See Treas. Reg. § 1.461(h)-4T, Q&A-1. Therefore, because the contribution at issue here was made in the [redacted] taxable year, economic performance for purposes of § 461(h) occurred in that year. Accordingly, the requirements of § 461(h) have been satisfied in this case.

Lastly, there are some practical considerations which warrant concession of this issue. First, on December 1, 1986, the Service issued VEBA Audit Guidelines (a copy of which is attached hereto) to the field for years ending on or before December 31, 1985. Under these guidelines the subject contribution would probably have been presumed to be reasonable and hence, entitled to the automatic I.R.C. § 7805(b) relief provided for under the regulations (see Treas Reg. § 1.419-1T, Q&A-10(c)). See Guidelines, at 3-4. And, because these

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*/ And, indeed, this would appear to be the correct conclusion as a technical matter, since the payment to an irrevocable trust, as here, plainly fixes the liability and the amount of that liability (here, the contribution made) is obviously determinable with reasonable accuracy.

Guidelines are available to the public, they could be brought to the Court's attention and therefore, have an adverse impact on this case. Second, the deduction issue here has yet to be litigated with respect to welfare benefit plans. At the same time, prior to the enactment of I.R.C. § 419 in 1984, there was considerable abuse in this area through the massive pre-funding of welfare benefit funds generally. Because the instant case is a legally weak one and the amount of pre-funding involved was not excessive (i.e., was almost entirely soaked up in the following year), we believe that litigation of the deduction issue should await a more egregious case.

Sincerely,

MARLENE GROSS
Director

By: Daniel J. Wiles
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Tax Litigation Division

Enclosure:
As stated.